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Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of Petition of Verizon for Forbearance From The Prohibition Of Sharing Operating, Installation, and Maintenance Functions Under Section 53.203(a)(2) Of The Commission's Rules	CC Docket No. 96-149

REPLY COMMENTS

Of Counsel
Michael E. Glover
Edward Shakin

Joseph DiBella

1515 North Court House Road
Suite 500
Arlington, VA 22201
Tel (703) 351-3037
Fax (703) 351-3676

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I. Introduction and Summary

The only opposition to Verizon's petition for forbearance comes from a few interexchange carriers, who clearly see the rules prohibiting the sharing of operating, installation, and maintenance ("OI&M") services between Verizon's local exchange companies and its section 272 affiliates as a means of shielding the interexchange carriers from the full force of competition. Although they claim that Verizon has overstated the costs of complying with the OI&M restriction, they admit that they see the restriction as a significant handicap that hinders Verizon from enjoying the full economies of scope from vertically integrating its workforce for local and long distance services. The point they miss is that neither the Commission nor Congress intended the section 272 provisions to be a cost handicap – these provisions were only designed to provide additional safeguards against discrimination and cross-subsidization during the initial period after a Bell operating company ("BOC") obtained section 271 authority to enter the in-region interLATA market. As Verizon and the other commenters demonstrate, the OI&M

restriction is not necessary for this purpose, and its costs far exceed what the Commission anticipated in the *Non-Accounting Safeguards Order*.[1]

Moreover, the interexchange carriers' arguments that the OI&M restriction is necessary to promote competition in the interLATA market are wrong on both the facts and the law. Even assuming that interexchange carriers rely upon the incumbent local exchange carriers' access services as essential inputs (an assumption that is completely unwarranted given the ever increasing extent to which competitors have used their own last mile facilities to compete on a vertically integrated basis), competition has flourished in other markets where unaffiliated carriers both compete with the BOCs and rely upon them for such inputs. Notable examples are the markets for customer premises equipment, inside wiring, information services, and intraLATA toll. In all of these markets, the BOCs compete on an unseparated basis. Yet, competition has flourished, the BOCs have minority shares of the markets, and the BOCs have no ability to impede competition from other providers. Furthermore, Congress never adopted an OI&M restriction for interLATA services, and it clearly believed that other safeguards such as access charge imputation and equal access were sufficient to promote interLATA competition.

Contrary to the arguments of the interexchange carriers, sharing of OI&M service between a BOC's local exchange and long distance services is economically beneficial as well as being consistent with the Telecommunications Act of 1996, which was designed to provide an incentive for all carriers to enter each other's markets and compete to provide consumers a full

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[1] See *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act of 1934, as amended*, 11 FCC Rcd 21905 (1996) ("*Non-Accounting Safeguards Order*").

range of services in the most efficient manner. The costly and unnecessary OI&M restriction should be removed so that consumers will reap the benefits of increased efficiency and greater competition in all markets.

II. Removal of the OI&M Restriction Would Not Give Verizon An Advantage Over Other Carriers – It Would Remove An Uneconomic Handicap.

Verizon's petition demonstrated that the OI&M restriction imposes a unique handicap on the BOCs that other providers of interLATA services can and do avoid through vertical integration of their local and long distance facilities and operations. ***See*** Verizon Petition, 7; ***see also*** BellSouth, 4; USTA, 4; SBC, 2-4. Despite the fact that only the BOCs are prevented from operationally integrating these services, AT&T argues (at 5-7) that removing the OI&M restriction would give Verizon and other BOCs a unique advantage over their non-BOC competitors. AT&T's real motives are painfully transparent, however. AT&T wants the Commission to retain the OI&M restriction as a handicap designed to artificially increase a BOC's cost of providing long distance service to its customers – a handicap that benefits AT&T but that ultimately hurts consumers. ***See*** id., 7.

This is exactly why the Commission should eliminate it. The Commission never attempted to justify the OI&M restriction as a financial or operational handicap, and retaining a prohibition simply to make the BOC less efficient would have no support in section 272 and it would contradict the pro-competitive objectives of the Telecommunications Act of 1996.

The 1996 Act was designed to open all markets to competition by eliminating the legal and regulatory restrictions that previously prevented carriers from competing in each other's markets. The Commission has found that;

> With removal of legal, economic, and regulatory impediments to entry, providers of various telecommunications services will be able to enter each other's markets and provide various services in competition with one another. Both the BOCs and other firms, most notably interexchange carriers, will be able to offer a widely recognized brand name that is associated with telecommunications services. As firms expand the scope of their existing operations to new product lines, they will increasingly offer consumers the ability to purchase local, intraLATA, and interLATA telecommunications services, as well as wireless, information, and other services, from a single provider (i.e., "one stop shopping"), and other advantages of vertical integration.[2]

Congress included the separate affiliate requirements of section 272 of the Act as a temporary transitional mechanism, because the local exchange markets were not expected to be competitive immediately upon enactment of the Telecommunications Act of 1996. ***See*** id., ¶ 9. The section 272 requirements were designed as additional safeguards to make doubly sure that there was no risk of discrimination and cost-shifting during the initial period when the BOCs began providing long distance service, not as handicaps to offset the lack of economies of scope that other carriers may lack if they do not offer integrated packages of local and long distance services. The Commission made it clear that it had no intention of imposing section 272 requirements on the BOCs that would unfairly handicap them in their ability to compete. ***See*** id., ¶ 13.

Yet, that is exactly how AT&T sees them, particularly the OI&M restriction. AT&T argues that interexchange carriers cannot offer integrated local and long distance facilities except in very limited circumstances, and that the OI&M restriction is necessary to prevent the BOCs from enjoying economies of scope and scale that are unavailable to other providers of long distance services. This is wrong on two levels. First, in any market where Verizon and other

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[2] *Non-Accounting Safeguards Order*, ¶ 7.

BOCs have the ability to offer interLATA services, they have met the competitive checklist in section 271 of the Act to demonstrate that the local exchange markets are open to competitive entry. Therefore, any competing carrier can use its own facilities to offer integrated local and long distance service and use a single OI&M workforce to install, operate, and maintain those facilities. Moreover, AT&T grossly understates the extent of actual competition in the local exchange markets, where competition is flourishing on both an intramodal and intermodal basis.[3] Second, the purpose of the Telecommunications Act of 1996 is to provide every carrier with an economic incentive to compete in every market by removing the barriers that may have previously protected them from competition from other carriers. Where sharing of OI&M services provides opportunities for economies of scope, carriers should be allowed to achieve them, because the ultimate beneficiary is the consumer. And allowing BOCs to take advantage of these economies will help to preserve incentives for other carriers to invest in their own competing local exchange services so that they can achieve the same efficiencies. In contrast, a carrier that chooses not to pursue such economies should not be protected from those that do,

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[3] *See Review of the Section 251 Unbundling Obligations of Incumbent Local Exchange Carriers*, CC Docket No. 01-338, Comments of Verizon, Attachment B, UNE Fact Report 2002, pp. I-1 to I-4 (filed April 5, 2002) ("*UNE Fact Report*"). AT&T argues that there is no support in the UNE Fact Report for Verizon's claim that competitive local exchange carriers ("CLECs") use their own last-mile facilities to serve the vast majority of their large business customers. ***See*** AT&T, Selwyn Reply Declaration, fn. 41. This is simply incorrect. On page IV-1 and in Table 1 following, the UNE Fact Report shows CLECs serve at least 13 million business lines through their own switches, and more likely closer to 20 million business lines, but that they have obtained only about 1.5 million stand-alone unbundled loops to serve business customers, meaning that the rest are served through their own last-mile facilities. In addition, competing carriers, including AT&T, provide basic telephone service using their own switches and their own loops to at least 1.5 million residential customers, and they provide broadband services to 7.5 million residential customers using their own facilities. ***See*** UNE Fact Report, pp. IV-10, IV-18.

particularly since the effect of providing that artificial protection would be to further undermine the incentives of all competing carriers to invest in order to achieve the same economies.

The interexchange carriers dispute Verizon's arguments that the OI&M restriction is particularly burdensome in the large business market, where customers expect to receive prompt and seamless service. ***See, e.g.,*** AT&T, 5-7; Selwyn Declaration, 16-25. However, their arguments are based entirely on the premise that the interexchange carriers provide services to large business accounts over competitive local access facilities only in "rare" circumstances. This clearly is incorrect. The large business market is the segment is where competition is most intense and where bypass of the incumbent local exchange carriers is the greatest. ***See*** attached Declaration of Timothy Tardiff ("Tardiff Declaration"), ¶¶ 17-18. In fact, AT&T in particular touts is own success in providing services directly to these customers. ***See*** id. AT&T has bragged that it uses its own local network to serve business customers in 90 cities and that it will have end-to-end private networking in all of these cities by April 2003. ***See*** http://www.att.com/ir/. AT&T has emphasized that this seamless network gives it the ability to provide focused customer support and delivery, faster installation and customer response times, improved accuracy, and higher overall customer satisfaction, exactly the reasons why Verizon argued that the OI&M restriction is particularly burdensome in the large business enterprise market. ***See*** id; Verizon Petition, Declaration of Steven G. McCully. Elimination of the OI&M restriction is especially important in this market segment, but it should be eliminated for all market segments so that all customers would get the benefits of the most efficient way of providing service. For instance, as Verizon showed in its petition, application of the OI&M restriction hinders developments in new technologies, such as broadband, where traditional distinctions between "local" and "long distance" have no meaning. ***See*** Verizon Petition, 5-6.

Sprint argues (at 17-19) that the OI&M restriction does not put Verizon at a competitive disadvantage, because other interexchange carriers are not able to offer integrated local and long distance services. Like AT&T, Sprint tries to characterize the local and long distance markets as inherently separate, and it completely dismisses both the ability of carriers to enter the local exchange market and the actual amount of entry that has already occurred. Carriers that have aggressively pursued vertical integration, such as CLECs, wireless carriers and cable companies, enjoy the economies of scope involved in sharing all services, including local and long distance. Sprint is simply wrong in arguing (at 18) that it is "exceptionally rare" that any carrier other than a BOC can offer seamless end-to-end service. CLECs are already doing so in thousands of locations throughout the country through their own local and long distance services, and long distance service is a "seamless" component of most wireless calling plans. Only the BOCs are prevented from fully realizing the cost savings produced by such sharing, and this disadvantage has hurt Verizon and other BOCs in competing with providers of a full platform of services, as evidenced by the increasing numbers of customers who are using their wireless phones in place of wireline telephone services. ***See, e.g.***, *Verizon Wireless' Petition for Partial Forbearance from the Commercial Radio Services Number Portability Obligation*, WT Docket No. 01-184, Memorandum Opinion and Order, FCC 02-215, ¶ 17 (rel. July 26, 2002) (finding that "wireless plans are substituting for traditional wireline long distance").

Sprint complains (at 18) that Verizon is already able to share services other than OI&M and that this gives it a cost advantage over other interexchange carriers.[4] It simply escapes Sprint that the Telecommunications Act of 1996 allows any carrier to achieve these cost savings, and more. A carrier that chooses to continue to provide long distance service on a stand-alone basis should not be heard to complain that it does not enjoy the efficiencies of other carriers that take advantage of the opportunities provided by the 1996 Act. Only the BOCs are prevented from enjoying the full benefits of combining their local and long distance workforces, and this is not the result of the provisions of the Act, but rather it is the result of the Commission's decision to add the OI&M prohibition to section 272. Forbearance from applying the OI&M restriction to Verizon would be consistent with the purpose of the 1996 Act and provide the maximum incentive for all carriers to provide one-stop shopping where doing so would be more efficient.

The interexchange carriers argue that the OI&M restriction does not handicap the BOCs, because the BOCs have been able to gain significant shares of the long distance market in a relatively short time despite it. ***See, e.g.***, AT&T, 4-5; Sprint, 18. These arguments are beside the point. They shed no light on the artificial costs imposed by the inefficient OI&M restriction. In any event, as the interexchange carriers concede, the BOCs' success in the long distance market is primarily the result of their marketing and sales efforts in addition to the offering of innovative pricing plans. The BOCs have courted the residential and low-volume customers that the

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[4] Of course, Sprint offers local and long distance services on an integrated basis in areas where it is the incumbent local exchange carrier, but it does not believe that this puts competing interexchange carriers at a disadvantage because Sprint's local operations are not as large or extensive as the BOCs'. ***See*** Sprint Comments, WC 02-112, p. 3 (filed Aug. 5, 2002). However, Sprint enjoys the cost efficiencies of vertical integration as much as any other carrier that offers both local and long distance services on an integrated basis. Clearly, Sprint does not think that this harms competition when and where it pursues such efficiencies.

established interexchange carriers were losing interest in, as well as pursuing large business accounts.[5] Moreover, the BOCs' success in the interLATA market is similar to the success of the interexchange carriers in gaining market share in the intraLATA market after the incumbent local exchange carriers began providing equal access for intraLATA service. The fact that the entry of the BOCs has shaken up the growing concentration in the interexchange market is just confirmation of the benefits that will flow from introducing added competition into that market segment – benefits that are greatest where all providers are permitted to compete in the most efficient manner possible.

III. The OI&M Restriction Is Not Necessary To Promote Competition In The InterLATA Market.

The interexchange carriers predict dire consequences for the interLATA market if the OI&M restriction were removed, arguing that, without it, Verizon would drive out competition and recreate the AT&T monopoly that preceded divestiture. ***See, e.g.,*** AT&T, 15-16, Selwyn Declaration, 5-10. This is based on their claim that the incumbent interexchange carriers have no choice but to rely almost exclusively upon Verizon and the other BOCs for essential inputs for their interexchange services, a claim that Verizon has demonstrated above and in its comments supporting sunset of the section 272 separate affiliate requirements is refuted by the extensive and growing level of competition in the local exchange market. ***See*** Verizon Comments, WC Docket No. 02-112, at 6-8 (filed Aug. 5, 2002). However, even if the interexchange carriers relied exclusively upon the BOCs for essential inputs (which they do not), separate affiliates in

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[5] ***See, e.g.,*** Paul Davidson, "Long-Distance Telcos Left Hanging", USA Today, Nov. 2, 2000 *available at* http://www.usatoday.com/life/cyber/invest/ina297.htm.

general and the OI&M restriction in particular would not be necessary to promote competition in the interLATA market. As is shown in the Tardiff Declaration, the Commission has extensive experience in other markets demonstrating that nonstructural safeguards are more than sufficient to ensure that the BOCs are not able to use their local exchange services to impede competition in adjacent markets.

The most direct evidence that the BOCs could not impede competition in the interLATA market if they provided those services on an integrated basis is that they have not done so in the intraLATA toll market or the interLATA corridor market. *See* Tardiff Declaration, ¶¶ 10-11. In both of these markets, the BOCs provide toll services on an integrated basis with their local exchange services, they share both network facilities and OI&M services between their local and toll services, and competing providers rely upon their access services to compete with the BOCs. Yet, with just the safeguards of equal access and access charge imputation, the markets have grown increasingly competitive, and the BOCs have lost market share from an initial position in which they had 100 percent of the market. In fact, the BOC market share in the intraLATA toll market began declining even before the Telecommunications Act of 1996 required nationwide intraLATA toll dialing parity. *See* id., ¶ 10. Today, the incumbent local exchange carriers in general have about 45 percent of the intraLATA toll market, a lower market share than AT&T had when it was declared non-dominant. *See* id., fn. 16. Clearly the fact that the BOCs were able to use the same OI&M workforce for both their local telephone services and their competitive intraLATA and interLATA services had no adverse effect on competition. There is no reason to believe that removing the OI&M restriction from the section 272 rules would have any different impact on any other interLATA market.

Another example is the information services market, where the Commission abandoned its previous structural separation requirement, finding that it had inhibited the introduction of new services by the local exchange carriers and that it was not necessary to ensure competition. *See* Tardiff Declaration, ¶ 12. Contrary to the claims of some parties that this would allow the local exchange carriers' information services, such as voice messaging, to dominate the market, the market is highly competitive, and the local exchange carriers have only a small market share despite the fact that unaffiliated information services providers use local exchange carrier inputs for many of their services. For instance, in the voice messaging market, the BOCs and GTE together account for just over 15 percent of total annual revenues, and there are hundreds of non-affiliated Internet service providers in the market. *See* id.

Likewise, the Commission allowed the local exchange carriers to offer customer premises equipment and maintenance of inside wiring services on an integrated basis. *See* id., ¶ 13. The carriers are permitted to use the same OI&M workforce to provide and maintain these services that they use to provide local exchange services, subject only to the same type of accounting safeguards that the BOCs would use to share OI&M services with their section 272 affiliates if the OI&M restriction were lifted. Although competing providers rely upon the local exchange carriers for interconnection of customer premises equipment and inside wiring when providing these services and products to the local exchange carriers' end users, the local exchange carriers have not impeded competition, and they have only small shares of these markets – again on the order of 15 percent. *See* id. Clearly, the same type of accounting safeguards for allocating shared service costs between regulated and nonregulated services that the Commission has used successfully for these services would work just as well in allowing sharing of OI&M for interLATA services.

IV. The OI&M Restriction Is Not Necessary To Prevent Discrimination.

Verizon's petition demonstrated that the OI&M restriction is not necessary to prevent discrimination in favor of its own interLATA services, as there are numerous safeguards in the Act and the Commission's rules implementing them that directly address this issue without the cost burdens of the OI&M restriction. ***See*** Verizon Petition, 9-10. For example, provisions such as sections 272(e)(1) and (e)(3) ensure parity of performance and access charge imputation for Verizon's own interexchange services. ***See*** SBC, 6. Sections 201 and 202 ensure the reasonableness of access charges, and section 251(c) and the Commission's network disclosure rules provide additional safeguards. ***See*** id.; ***see also*** BellSouth, 3. USTA argues that the Commission's decision to impose the OI&M restriction did not take into account the protections against non-discrimination already provided in these sections as well as in sections 272(b)(2) through (5). ***See*** USTA, 2. SBC points out that the Commission has ample authority to enforce these provisions through sections 503, and 206-209 of the Act. ***See*** SBC, 6-7. Clearly, the excessive burden of the OI&M restriction cannot be justified by concerns about discrimination when these less costly safeguards are already available.

Nonetheless, the interexchange carriers argue that the OI&M restriction is necessary to prevent discrimination in favor of Verizon's own interexchange services, arguing that the Commission found such discrimination would be "inevitable" without the OI&M restriction. ***See*** AT&T, 7-9; Sprint, 11-14. Congress certainly did not think so – rather than prohibiting the sharing of services between a BOC and a section 272 affiliate, Congress adopted a specific nondiscrimination requirement in section 272(c) that prohibits the BOC from discriminating between the separate affiliate and other entities in the provision of services. ***See*** 47 U.S.C. § 272(c)(1). As this is not limited to telecommunications services, it presumes that the BOCs would be permitted to provide other services to their section 272 affiliates. *See Non-Accounting Safeguards Order*, ¶ 217. In addition, Congress enacted specific nondiscrimination requirements in section 272(e) that prevent discrimination in favor of the section 272 separate affiliate. Section 272(e)(1) requires a BOC to fulfill requests from unaffiliated entities for telephone exchange service and exchange access within a period no longer than the period in which it provides such service to itself or to its affiliates; section 272(e)(2) prohibits a BOC from providing facilities, services, or information concerning its provision of exchange access to the separate affiliate unless such facilities, services or information are provided to other providers of interLATA services on the same terms and conditions; section 272(e)(3) requires a BOC to charge its separate affiliate, or to impute to itself, an amount for access to its telephone exchange service and exchange access that is no less than the amount charged to any unaffiliated interexchange carriers for such service; and Section 272(e)(4) allows a BOC to provide interLATA or intraLATA facilities or services to its separate affiliate only if it provides such facilities or services to all carriers at the same rates and on the same terms and conditions.[6]

As BellSouth points out (at 2), if Congress had intended to prohibit sharing of OI&M services, it would have done so in section 272 explicitly as it did in section 274, where it prohibited a BOC from performing installation or maintenance services on behalf of its separate

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[6] Sprint is wrong in arguing (at 11) that the Commission found that the OI&M restriction is necessary to implement the requirements of section 272(e)(4). Sprint misinterprets paragraph 164 of the *Non-Accounting Safeguards Order*, where the Commission found that section 272(e)(4) is not a separate grant of authority to the BOCs to share services such as OI&M with its separate affiliates. The Commission never found that section 272(e)(4) *prohibited* the sharing of OI&M services. In fact, the Commission specifically rejected the argument that section 272 prohibits the BOCs from providing services to the separate affiliate. *See Non-Accounting Safeguards Order*, ¶ 178-179.

electronic publishing affiliate. *See* 47 U.S.C. § 274(b)(7)(B). Congress' decision not to prohibit the sharing of services between the BOC and the section 272 affiliate is clear evidence that it did not intend the "operate independently" requirement of section 272(b)(1) to include a restriction on the sharing of OI&M services.

The interexchange carriers complain that the BOCs have already discriminated in favor of their section 272 affiliates, but they point to no actual instances where the BOCs have violated the rules concerning sharing of services between a BOC and a section 272 affiliate. For example, Sprint points (at 12) to a finding of the New York commission that Verizon meets service appointments for its own retail customers more often than it does for carrier service requests. However, this finding, which Verizon demonstrated is the result not of discrimination, but of differences in how retail and wholesale appointments are counted as "missed," does not demonstrate any discrimination in favor of Verizon's section 272 affiliates.[7] Moreover, the New York commission was examining special access performance, not Verizon's adherence to non-discrimination standards for shared services. Similarly, Sprint's complaints about SBC's failure to meet performance standards has nothing to do with sharing of internal services between affiliates.

Sprint also makes a general allegation that Verizon and other BOCs have repeatedly violated the Commission's rules, but in its zeal to put the BOCs in the most unfavorable light, it cites completely misleading lists of BOC "penalties and fines" on the interexchange carriers'

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[7] *See Proceeding on Motion of the Commission to Investigate Methods to Improve and Maintain High Quality Special Service Performance by Verizon New York, Inc.*, Case 00-C-2051, State of New York Public Service Commission, Opinion No. 01-1, 5-6 (issued June 15, 2001).

"grassroots" web site. The performance "penalties and fines" listed on the web site and cited by Sprint are almost entirely performance payments that carriers such as Verizon and SBC agreed to pay as part of the carrier-to-carrier performance conditions of their merger approvals.[8] First, *these payments have nothing to do with discrimination in favor of the BOCs' long distance* affiliates. In fact, the payments are the result of carrier-to-carrier performance plans designed to measure performance for services provided to other competitors in the local exchange market. *See Bell Atlantic/GTE Merger Order*, 15 FCC Rcd 14032, ¶ 279 (2000). Second, these payments are not fines or penalties – they are payments that apply automatically without a finding that Verizon has discriminated or has otherwise violated any statute or regulatory requirement. ***See*** id., ¶ 282. In fact, the plans go well beyond requirements of the Act.[9] Similarly, Sprint lists as "fines" payments made as part of consent decrees that specifically state that the Commission has made no findings that Verizon has violated any rules. ***See, e.g., Verizon Communications Inc.***, File No. EB-01-IH-0519, Order, DA 02-2017, Consent Decree, ¶ 21 (rel. Aug. 20, 2002). These gratuitous swipes at the BOCs provide no evidence that removal of the OI&M restriction would result in discrimination in favor of the Verizon's section 272 affiliates.

[8] ***See, e.g.,*** http://www.voicesforchoices.com/1091/wrapper.jsp?PID=1091-43.

[9] For example, the Verizon East performance measurements are based on the measurements adopted in the New York collaborative process, which the New York commission has found "exceed the Section 271 checklist requirements." New York Public Service Commission, *Order Adopting the Amended Performance Assurance Plan and Amended Change Control Plan*, Nos. 97-C-0271 and 00-C-0949, p. 3 (issued Nov. 3, 1999); *Bell Atlantic/GTE Merger Order*, ¶ 281.

V. The OI&M Restriction Is Not Necessary To Prevent Misallocation Of Costs.

Verizon also demonstrated that the OI&M restriction is not necessary to prevent misallocations of costs between interLATA services and local exchange services. ***See*** Verizon Petition, 4-5. BellSouth agrees that there is no fundamental difference between the cost allocations needed to monitor the sharing of OI&M services and the cost allocations applied to administrative services for which sharing is already permitted between a BOC and its section 272 affiliates. ***See*** BellSouth, 3. SBC explains that the Commission's detailed accounting and cost allocation rules, including the affiliate transaction rules, prevent any cost misallocation. SBC, 5-6.

The interexchange carriers claim that the OI&M restriction is necessary to prevent Verizon from misallocating its costs between local and interexchange services. ***See*** AT&T, 9-12; Sprint, 8-11; WorldCom, 5-6. They argue that the sharing of OI&M services provides greater opportunity for misreporting of costs than the sharing of administrative services. However, they ignore the fact that Verizon and the other BOCs have been performing similar cost accounting for OI&M functions between regulated and nonregulated services for years. The BOCs have provided nonregulated services such as inside wiring maintenance, customer premises equipment, and information services using shared personnel and facilities for over a decade using cost allocations rather than separate affiliates. The Commission has been able to monitor these cost allocations effectively through its accounting rules, cost allocation manuals, and biennial cost allocation audits. In fact, the sharing of OI&M services between the Verizon BOC and its section 272 affiliate will be subject to even greater accounting safeguards than these services under the Commission's affiliate transaction rules and the section 272 requirements that transactions between the BOCs and the separate affiliates be conducted on an arms-length basis, be reduced to writing, and be made publicly available. *See* 47 U.S.C. § 272(b)(5). There is no reason to believe that cost accounting rules will be less effective for sharing of OI&M services than for the sharing of similar services in other contexts.

Moreover, the interexchange carriers ignore the fact that there is no longer any incentive to misallocate costs, because the BOCs can gain no competitive advantage by doing so. When the Commission adopted the OI&M restriction, it noted that a carrier could have an incentive to misallocate costs only if it were regulated under rate-of-return regulation, a price caps structure with sharing, or a price caps scheme that adjusts the x-factor periodically based on changes in industry productivity, or if the revenues it is allowed to recover are based on costs recorded in regulated books of account. *See Non-Accounting Safeguards Order*, ¶ 10. None of these conditions applies to Verizon or to the other price cap local exchange carriers. Verizon is regulated under price caps without a sharing mechanism in the federal jurisdiction and in the vast majority of states, and the CALLS plan adjusts the x-factor to the consumer price index when the local switching rate hits the target rate (which has already occurred in Verizon East and in all but a few study areas in Verizon West). *See* Tardiff Declaration, ¶¶ 19, 22. Verizon has no incentive to misallocate the costs of its competitive services to regulated accounts, as doing so would not permit Verizon to raise its rates for regulated services.

Sprint claims (at 8-9) that Verizon has misallocated costs for administrative services by not following the affiliate transaction rules for valuing sales and marketing services, which requires services provided by a BOC to an affiliate to be priced at the higher of fair market value or fully distributed cost. This is a reference to Verizon's first section 272 audit, where the auditor noted that Verizon had not obtained fair market value calculations for certain unique services because Verizon's independent accountant could not identify a market price for these services. This is not a violation of the Commission's affiliate transaction rules. ***See*** *Accounting Safeguards under the Telecommunications Act of 1996*, CC Docket No. 96-150, Report of PricewaterhouseCoopers, Appendix A, p. 21 (filed June 11, 2001). If no fair market value exists, the services are to be priced at fully distributed cost, which is what Verizon did.

VI. The Burdens Of The OI&M Restriction Far Outweigh Any Conceivable Benefits.

In its petition, Verizon demonstrated that the costs of complying with the OI&M restriction are far greater than anyone anticipated when the Commission adopted it in the *Non-Accounting Safeguards Order*. The interexchange carriers argue that Verizon has overstated the costs of the OI&M restriction and that it has not substantiated its cost estimates. ***See*** AT&T, 12-14; Sprint, 14-16; WorldCom, 7. These arguments are without merit. Verizon performed a detailed evaluation of the costs it has already incurred and will incur in the future as a result of the OI&M restriction. As Verizon demonstrated, it has already incurred approximately $197 million to comply with the OI&M restriction, and it expects to incur an additional $298 million over the next four years as a result of this restriction. ***See*** Verizon Petition, Declaration of Fred Howard ("Howard Declaration"), ¶ 5. Verizon developed this analysis based on its section 272 affiliate's actual costs for the 1998 through 2002 period as well as the affiliate's projected budget for the 2003 through 2006 period. Because these data are confidential, and because disclosure would give competing interexchange carriers insight into the company's cost of service and its plans for the future, Verizon did not include the backup data in its petition. However, to provide additional support for its cost estimates, Verizon has provided in Attachment A an explanation of the methodology by which it identified the costs of complying with the section 272 rules, and in particular the costs of continuing to comply with the prohibition on sharing OI&M services.

As is shown Attachment A, Verizon developed its cost analysis by examining the costs and operations of Verizon Global Networks Inc., ("GNI"), the Verizon section 272 affiliate that provides underlying interLATA network facilities to other Verizon section 272 affiliates. For each category of expense that supports OI&M activities, Verizon estimated the percentage of these expenses that would not have been incurred had GNI been able to share use of Verizon BOC personnel and facilities to provide OI&M services. Because the provision of interLATA services requires the provision of additional facilities and work to meet the increased demand, the costs of section 272 compliance is the amount that was incurred or will be incurred in addition to the incremental cost that would otherwise be incurred to provide the additional interLATA services. The cost categories that are impacted by the OI&M restriction are as follows;

- **Professional Services.** This includes expenses for outside vendors that GNI engaged to perform OI&M services on its network. Verizon estimates that 95 percent of these costs are due to the OI&M restriction, because almost all of the field work could be done by BOC employees.
- **GNI employees.** This includes internal GNI technical employees hired to provide OI&M functions. Although GNI startup required employees with skill sets specific to the long distance network architecture, some efficiencies could be obtained in the absence of the OI&M restriction for job functions that do not require a dedicated staff for the long distance network. Verizon estimates that 30 percent of these costs could be avoided in the absence of the OI&M restriction.
- **Operating Support Systems.** Many of the operating support systems that GNI developed separately to comply with the OI&M restriction, such as inventory, provisioning, order management, trouble management, could have been developed through modification of the BOC systems and reused at a fraction of the costs incurred to develop new systems. The operating support system expense category includes software and hardware maintenance, licenses and right-to-use fees, and

non-capital software development. Verizon estimates that 65 percent of these expenses are driven by the OI&M restriction.

- **Network Operations Center.** The network operations center provides monitoring and control of the long distance network. Although the long distance network requires additional operations, Verizon estimates that 30 percent of the costs of the network operations center could be avoided by using the BOC network operations center to provide these functions.
- **Back Office Provisioning, Calling Card, and Repair.** These back office functions for GNI are driven almost entirely by the OI&M restriction. For instance, Verizon would not have built the Altoona or Worcester operator services facilities if these services could have been obtained from the BOC, and most of the costs of the error management and repair centers could have been avoided by using BOC services. Verizon estimates that 80 percent of its expenses in this category are the result of the OI&M restriction.

These estimates are reasonable. SBC, which is the only other BOC that has had substantial experience in complying with the OI&M restriction, estimates (at 2-3) that it could avoid even greater percentages of engineering and network operations personnel expenses if the restriction were eliminated.

Sprint is incorrect in arguing (at 16) that these costs are inflated due to the fact that Verizon maintains more than one section 272 affiliate. Verizon only has one section 272 affiliate that provides a long distance network, and only the costs of this affiliate are included in Verizon's analysis of OI&M costs. The other Verizon section 272 affiliates are retail entities that do not perform OI&M work. Having more than one legal entity that provides interLATA services does not create additional inefficiencies, as those entities are allowed to share services among themselves when it is most efficient to do so.

AT&T argues (at 13) that Verizon's cost analysis is incomplete, because Verizon did not include the costs that it would incur to reintegrate the section 272 affiliate if the OI&M restriction were eliminated. This is not accurate. Verizon made a realistic assessment of the actual cost savings that it could achieve if the OI&M restriction were eliminated today, recognizing that it would not be economic to eliminate all of the systems and facilities that it has already established to allow GNI to perform OI&M functions on a stand-alone basis. For that reason, although Verizon estimated that it will incur approximately $298 million from 2003 to 2006 to comply with the OI&M restriction, it would be able to avoid only about $183 million during this time period if the OI&M restriction were eliminated today. *See* Howard Declaration, ¶ 5; Attachment A, Table 3. However, this is still a substantial sum, and elimination of the OI&M restriction clearly would provide significant benefits with no loss in regulatory oversight.

The interexchange carriers argue that these costs are outweighed by the benefits of avoiding discrimination and misallocation of costs. *See, e.g.*, Sprint, 15-16; WorldCom, 7. However, as Verizon has demonstrated, enforcement of the anti-discrimination provisions of the Act and the Commission's cost-allocation rules can be accomplished effectively at far less cost than Verizon incurs to comply with the OI&M prohibition. The economic waste caused by the OI&M restriction inevitably is passed along to consumers in the form of weaker competition, higher prices, and less investment and innovation. Continued application of the OI&M restriction clearly fails any cost-benefit analysis.

VII. Verizon Has Met The Standards For Forbearance.

Verizon has met the standards for forbearance from the OI&M restriction.[10] Enforcement of the OI&M restriction is not necessary to ensure that rates are just, reasonable, and non-discriminatory, because the restriction is not necessary to prevent cross-subsidization of Verizon's interLATA services or to prevent discrimination in favor of Verizon's section 272 affiliates. *See, e.g.,* SBC, 5-7; *see also* Tardiff Declaration, ¶¶ 15-22. Enforcement of the restriction also is not necessary for protection of consumers and forbearance is in the public interest, because removal of the OI&M restriction will avoid harmful duplication of costs that make the BOCs less efficient and increase costs to consumers. *See* Verizon Petition, 8-10; Tardiff Declaration, ¶ 8. Elimination of costly and unnecessary regulatory requirements is particularly critical at this time, as traditional wireline telecommunications carriers struggle with declining lines and traffic levels due to the economic slowdown and increased competition from CLECs, wireless carriers, cable companies, and other providers of telecommunications services. Forbearance from applying the OI&M restriction is one of the few things that the Commission can do that would have an immediate impact in helping the carriers to improve both their productivity and the quality of service to customers.

The interexchange carriers argue that retention of the OI&M restriction is necessary to promote competition, because without it Verizon will cross-subsidize its long distance services

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[10] As SBC notes (at 2), the OI&M restriction is contained in the Commission's rules in section 53.203(a)(2), which prohibits the section 272 affiliate from performing OI&M services on facilities owned by the BOC, as well as in section 53.203(a)(3), which prohibits a BOC or BOC affiliate from performing OI&M service on facilities owned by the section 272 affiliate. Although Verizon only cited the first section in the caption of its petition for forbearance, the petition requests relief from the entire OI&M restriction, which includes section 53.203(a)(3).

and harm both consumers and competition. ***See, e.g.***, Sprint, 20-22; AT&T, 14-16. However, as Verizon and the other commenters have shown, the OI&M restriction is not necessary to prevent cross-subsidization, as the Commission has numerous regulatory tools to prevent it, and any misallocation of costs would be ineffective in any event because price caps would prevent Verizon from being able to increase its rates that are still subject to competition. ***See, e.g.***, SBC, 5-7; Tardiff Declaration, ¶ 19.

Sprint's argument (at 22) that the OI&M restriction is necessary to give Verizon a "spur of competition" is most revealing. Sprint sees the OI&M restriction as a handicap that places Verizon in the same position as another carrier that decides not to vertically integrate local and long distance services. Clearly, the OI&M restriction inhibits competition and investment in the local exchange market by limiting the incentive for other carriers to enter that market. Removal of an unnecessary regulatory restriction on the BOCs can only "spur" additional competition and investment by both the BOCs and the incumbent interexchange carriers by giving all of them an incentive to provide a full range of telecommunications services in the most efficient manner.

The interexchange carriers' backward focus is also revealed by their failure to dispute Verizon's argument that the OI&M restriction also retards development of the broadband market. As SBC points out, deploying separate personnel and breaking out the work into piece parts makes no sense in the context of broadband technologies, and it hampers the BOCs in providing service in this emerging market, where the dominant providers – the cable companies – do not face similar restrictions. ***See*** SBC, 4. AT&T's silence on this issue is particularly revealing considering its interests in cable companies and its use of cable facilities to compete with the

BOCs. Clearly, the public interest in fostering deployment of broadband facilities shows that forbearance from applying the OI&M restriction is in the public interest.

WorldCom argues (at 1-3) that the Commission cannot forbear from applying the OI&M restriction to Verizon, because section 10(d) of the Act states that the Commission may not forbear from applying the requirements of section 271 until it determines that those requirements have been fully implemented. WorldCom argues that section 271 requires a showing that a grant of authority to provide in-region interLATA service will be carried out in accordance with section 272, and that this includes the OI&M restriction as part of the requirement for the section 272 separate affiliate to "operate independently" from the BOC.[11] However, the OI&M restriction is not a requirement of section 272. Section 272 prohibits the section 272 affiliate and the BOC from sharing "officers, directors and employees," but it says nothing about sharing services. As BellSouth notes (at 2), if Congress had intended to include an OI&M restriction in section 272, it would have done so explicitly, as it did in section 274, which requires a separate affiliate to offer electronic publishing. Like section 272, section 274 contains requirements that the separate affiliate be "operated independently from the BOC" and have separate "officers, directors and employees," but section 274 also prohibits the BOC from performing "purchasing, installation, or maintenance" on behalf of the separate affiliate, while section 272 does not. ***See*** 47 U.S.C. § 274(b). Clearly, Congress viewed any prohibition of the sharing of services as an additional requirement above and beyond the requirement to "operate independently." Therefore,

[11] In fact, the Commission has already made the findings required by section 271 in approving Verizon's applications for authority to provide in-region, interLATA service. ***See, e.g.***, *Application of Verizon Pennsylvania Inc., et. al for Authorization To Provide In-Region, InterLATA Services in Pennsylvania*, 16 FCC Rcd 17419, ¶ 124 (2001) (finding that Verizon will comply with the requirements of section 272 of the Act).

the OI&M restriction is not a requirement of section 272, and the Commission may forbear from applying it to Verizon under section 10.

Conclusion

For the foregoing reasons, the Commission should forbear from applying the OI&M restrictions in sections 53.203(a)(2) and (3) to Verizon.

Respectfully submitted,

By: ______________________
Joseph DiBella
1515 North Court House Road
Suite 500
Arlington, VA 22201-2909
(703) 351-3037
joseph.dibella@verizon.com

Attorney for the Verizon companies

Of Counsel
Michael E. Glover
Edward Shakin

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